



## **State Investment Commission**

### **Monthly Meeting Minutes**

**Wednesday, January 23, 2013**

**9:00 a.m.**

**Room 135, State House**

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:04 a.m., Wednesday, January 23, 2013 in Room 135, State House.

### **I. Roll Call of Members**

The following members were present: Ms. Rosemary Booth Gallogly, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Paula McNamara, Ms. Marcia Reback, Mr. Andrew Reilly and General Treasurer Gina Raimondo. Mr. Fay left at 11:30.

Also in attendance: Mr. Thomas Lynch of Cliffwater, Alternative Investment Consultant to the Commission; Mr. Alan Emkin (by phone), Mr. John Burns, Ms. Judy Chambers, of Pension Consulting Alliance (PCA), General Policy Consultant; Ms. Sally Dowling, of Adler Pollock, Legal Counsel to the Commission; Mr. Mark Sullivan of BNY Mellon; Ms. Ann Yerger of the Council of Institutional Investors (CII); Beth MacLean and Jeff Muehlethaler of Pacific Investment Management Company (PIMCO); TJ Settel and Gary Slavin of Western Asset Management Company (WAMCO); Anne-Marie Fink, chief investment officer and members of the Governor's and Treasurer's staff. Treasurer Raimondo called the meeting to order at 9:04 a.m.

### **II. Approval of Minutes**

On a motion by Ms. Reback and seconded by Ms. Booth Gallogly, it was unanimously **VOTED: To approve the draft of the minutes of the December 19, 2012 meeting of the State Investment Commission.**

### **III. Bank Loan/High-Yield Recommendation**

Ms. Fink explained the SIC accepted PCA's recommendation in May to reduce fixed income exposure by 3% and increase our real return allocation by 5% by adding rate-insulated securities. She said the portfolio will be primarily floating-rate bank loans and shorter-duration high-yield. She explained Treasury staff and PCA put out an RFP and received 52 responses. She pointed out one of the responses was J.P. Morgan, who was her previous employer, so she recused herself from the process once she became aware of their involvement in the RFP. She introduced Mr. Kem Edwards, Treasury staffer, and Mr. Burns who both led the RFP process.

Mr. Edwards said our findings during the RFP process met the objectives of the mandate set forth by the SIC. He explained there is no free lunch for the market environment we face and it is not a risk free product, but it is meant to align with the risks the SIC has discussed.

Mr. Edwards said of the 52 responses, PCA gathered 28 which met the minimum qualifications. These 28 firms were put through a rigorous, multi-step analysis. Each was discussed individually and then ranked qualitatively. He explained this process created a natural break of 9 firms which stood out from the rest, but those firms were pretty tightly clustered. The review team then conducted phone interviews with each of the 9 managers asking uniform and specific questions around each. Mr. Edwards and Mr. Burns then visited 7 managers on-site and after this process the team focused efforts on 5 of those. After another layer of in-depth review the pool was reduced to three and ultimately to the 2 firms who will present today. Mr. Edwards explained during this review process each team member would take notes independently and then compare notes and throughout the process the take-aways were strongly aligned. He then reviewed general findings from the RFP process and trends in general.

Mr. Edwards described the two finalists as peer leaders with strong or best-in-class aspects across the board. He explained PIMCO is a bit more conservative which focuses on more liquid names. WAMCO tends to go a bit further out on the credit curve, but both firms have highly developed risk management processes. He pointed out, when placed together these two firms create a good pairing for the portfolio. Individuals from PIMCO entered the room and were introduced.

Ms. MacLean stated PIMCO is excited about this mandate because it fits in with their macro views. Ms. MacLean discussed the fundamentals in the market and valuations. She explained companies have managed their balance sheets well and discussed the corporate credit fundamentals. She expects a low default environment in the coming years and pointed out there is adequate supply of bank loans and high-yield bonds to meet the demand coming from institutional investors.

Ms. MacLean described PIMCO's team and the portfolio management structure. She explained the bottom-up model their research analysts use and their process for new investments as well as a monitoring system for active investments. She pointed out their risk management team is on the trading floor with them and also explained their investment committee meets daily.

Mr. Fay asked about default rates and how it relates to performance and Ms. MacLean pointed out PIMCO's default rate has been below market because of their rigorous credit selection process and higher quality bias. She explained the fund did not perform as well in the recent beta rally, because they did not own as many distressed credits. Conversely, PIMCO anticipates outperforming the market during a selloff.

Mr. Reilly asked about their view of interest rate risk and Ms. MacLean believes interest rates may stay low for the next 12-24 months. She thinks once rates spike there will be inflation and PIMCO is very concerned about this. She pointed out bank loans are the only assets in fixed income which don't perform poorly in a rising interest rate environment. There being no further questions for the presenters, Ms. MacLean and Mr. Muehlethaler left the room.

Individuals from WAMCO entered the room.

Mr. Edwards introduced Mr. Settel and Mr. Slavin. Mr. Slavin began the presentation and explained some of their investment fundamentals, their office locations, the structure of their investment and client service teams and their list of clients. He then touched on their historical results and explained how they exceeded the benchmark of their peer groups. He also explained, despite this, they have historically had less defaults than their peer group. He attributes this to their credit selection process and their ongoing monitoring systems.

Mr. Settel introduced himself as the bank loan portfolio manager and explained his background and the global credit team. He explained their different committees and their communication structure across portfolios. Mr. Settel explained their risk management process worked in 2008 and the company invested a lot of money to enhance their systems post-2008. He explained their analysts' bottom-up review process.

Mr. Fay asked about sell discipline in the bank loan space and he explained they focus on larger, more liquid names.

Treasurer Raimondo asked how much they manage in bank loans and Mr. Settel said they are about \$7B right now and the market is about \$600B. Treasurer Raimondo asked about the demand for the product going forward and Mr. Settel discussed return expectations.

Mr. Reilly asked about portfolio options and Mr. Settel referenced the presentation which laid out a variety of options and bandwidths. He concluded the presentation and they left the room.

The committee discussed the recommendation from PCA to hire PIMCO in the range \$200-\$250M and WAMCO at \$150-\$200M.

Ms. Fink suggested the committee approve these ranges and have a discussion about how much risk the committee is comfortable taking in this asset class. She discussed how each manager would complement each other and discussed diversification within the asset class.

Ms. McNamara asked about the funding timeline and Ms. Fink said she is more inclined to let them phase into the market.

On a motion by Mr. Fay and seconded by Mr. Reilly, it was unanimously

**VOTED: To approve PCA's recommendation selecting the two managers in the ranges as presented.**

## IV. Infrastructure Policy Statement

Ms. Chambers discussed the changes made in the document since the draft was presented last meeting.

Treasurer Raimondo stated the intent was to balance the concerns about labor while making sure we don't narrow the field of firms we will be able to work with.

Ms. Booth Gallogly asked how these policies are implemented and enforced and Ms. Chambers said the implementation falls on the investment manager and it is PCA's and staff's responsibility to monitor their activities.

The committee discussed the process in the event a manager does violate the investment policy.

Mr. Emkin pointed out there are many other large investors who share the committee's concern and the managers are sensitive to labor issues, given their long histories with limited partners in Europe and Australia. He also stated fiduciary responsibility is first priority.

Ms. Fink stated this will also be part of the evaluation process and we can proactively discuss the importance of this to the managers before we fund the mandate.

Ms. Chambers reiterated this policy is consistent with others in the marketplace.

Treasurer Raimondo recommended going to market to see if there are any viable managers which meet our guidelines and want to be good partners and the board could make an educated decision then.

On a motion by Ms. Reback and seconded by Ms. Booth Gallogly, it was unanimously **VOTED: To approve the updated investment policy statement as is.**

## **V. Corporate Governance Briefing**

Ms. Fink said the goal of this program is to find a cost-effective way to leverage our assets through a comprehensive corporate governance program. She introduced Ms. Yerger of CII. Ms. Yerger described her background and pointed out Rhode Island has been a member on and off since 2002. She explained CII's mission is to be a voice for strong investor protections and shareholder rights and for effective corporate governance standards for U.S. companies. She explained their founding and why corporate transparency is important. She explained they have over 125 voting members comprising public, labor and corporate pension funds. Ms. Yerger then explained there are a variety of options for investors to get involved with corporate governance and each plan should take into consideration its resources, objectives, philosophies and strategies. She continued to take the board through its options to get involved. She explained the board must evaluate how its proxies are being voted and most funds of Rhode Island's size delegate the voting to their asset managers. She pointed out if the plan does delegate there is an obligation to monitor. She reviewed some helpful questions to ask managers and also provided more enhanced options which might require more staff time. Ms. Yerger reviewed some current corporate governance issues such as majority voting for directors, executive pay, board diversity, political contributions, predatory lending and firearm divestments.

## **VI. Legal Counsel Report**

Mr. Mark Dingley, Treasury legal staffer, reviewed the 2010 Supreme Court Morrison decision which stated you can't bring a securities class action for a stock if it wasn't sold on a U.S. exchange. He explained the plan buys a lot of securities on foreign exchanges and our securities class action attorneys don't service those needs. Mr. Dingley proposed sending out an RFQ to determine which firms can provide effective advice on foreign actions. The board asked Mr. Dingley to proceed.

## **VII. CIO Report**

Ms. Fink walked the board through the new board book post-custody transition and explained it is a work in progress. She asked for feedback if the board would like any changes. She reviewed the performance and risk metrics in the process. She then gave a brief update on Wellspring.

Ms. Fink then reviewed the monthly performance of each hedge fund. She updated the board on a key person departure at Gracie. It was determined the board could not vote on Cliffwater's recommendation to redeem from Gracie because this item was not on the agenda. In an effort to adhere to the Open Meetings Act the board scheduled an interim meeting that coming Friday. She gave a brief update on the 457 plans and gave an update on an issue with Valic.

## **VIII. Treasurer's Report**

Mr. Vincent Izzo, Treasury cash manager, gave an update on the banking RFP. He explained regardless of what decisions are made the state will be paying less in fees.

## **IX. Adjournment**

There being no other business to come before the Board, on a motion by Mr. Giudici and seconded by Mr. Reilly the meeting adjourned at 12:15 a.m.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Gina Raimondo".

**Gina M. Raimondo**  
General Treasurer